

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

SECTION 407 INQUIRY

Docket No. PI2012-1

**COMMENTS OF THE UNITED STATES POSTAL SERVICE**  
(August 27, 2012)

The United States Postal Service (Postal Service) hereby submits comments in response to Postal Regulatory Commission Order No. 1420, Notice Providing Opportunity to Comment on Development of Commission Views Pursuant to 39 U.S.C. § 407(c)(1) (July 31, 2012).

**I. Overview**

The Postal Regulatory Commission (Commission) has requested that parties provide comments on “the principles that should guide the development of its section 407 views on rate and classification proposals subject to subchapter I of chapter 36 of title 39 of the U.S. Code [provisions relating to market dominant products].” Order No. 1420 at 4. Although not specifically stated in the Order, the Commission essentially is requesting public comment on proposals submitted for the Universal Postal Union (UPU) Congress regarding terminal dues.<sup>1</sup> Terminal dues are payments made by postal operators to compensate the destination country for the

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<sup>1</sup> The Postal Service understands the Commission is also reviewing and may express views on other proposals before the UPU Congress. While these comments focus entirely on the issue of terminal dues, the Commission should not view the Postal Service’s primary interest about terminal dues as indifference as to the other proposals.

cost incurred for the handling, transport and delivery of letter-post items from abroad. Terminal dues are established through a framework within the Universal Postal Convention (hereinafter UPU Convention) Articles 27, 28 and 29. This framework establishes the method for calculating terminal dues payments among postal operators based on numerous factors, including mail volume, mail weight and postal development. Together, these factors establish rates charged by postal operators, caps and floors for increases in these rates, and postal development goals and timetables for postal operators.

In response to the request from the Commission, the Postal Service first addresses the Commission's authority in the context of this docket. The Postal Service next summarizes the primary UPU Congress proposals regarding terminal dues which are affected by section 407. The Postal Service then separately examines the impact of the proposals on mailers in the United States, the Postal Service and foreign postal operators and their mailers. Finally, the Postal Service provides corrections to some of the representations made by Mr. James Campbell in his draft comments filed with the Commission on August 14, 2012.

## **II. Analysis**

### **A. Scope of Commission's Authority**

Pursuant to 39 U.S.C. § 407(b)(1), "[t]he Secretary of State shall be responsible for formulation, coordination, and oversight of foreign policy related to international postal services . . . ." As part of that oversight responsibility, "[b]efore concluding any treaty, convention, or amendment that establishes a rate or

classification for a product subject to subchapter I of chapter 36, the Secretary of State shall request the Postal Regulatory Commission to submit its views on whether such rate or classification is consistent with the standards and criteria established by the Commission under section 3622.” 39 U.S.C. § 407(c)(1). “The Secretary shall ensure that each treaty, convention, or amendment concluded under subsection (b) is consistent with the views submitted by the Commission . . . except if, or to the extent, the Secretary determines, in writing, that it is not in the foreign policy or national security interest of the United States to ensure consistency with the Commission's views.” *Id.* at 407(c)(2).

Accordingly, the Commission is tasked with providing its view on whether proposals submitted for the UPU Congress which relate to rate or classifications of market dominant products, as established in 39 U.S.C. § 3622, are consistent with the objectives and factors of subsections (b) and (c). With respect to international rates related to issues before the upcoming UPU Doha Congress, the Commission furnishes a view on inbound rates for letter post mail, also known as terminal dues. Letter post mail consists of: (1) priority items and non-priority items, up to 2 kilograms; (2) letters, postcards, printed papers and small packets, up to 2 kilograms; (3) literature for the blind, up to 7 kilograms; and (4) special bags containing newspapers, periodicals, books and similar printed documentation for the same addressee at the same address called “M bags”, up to 30 kilograms. See UPU Conv. Art. 12:2.1. Only inbound terminal dues rates are evaluated in the context of section

407(b) because these are rates for which the Postal Service receives revenue.<sup>2</sup>

In developing its comments, the Commission should be guided primarily by the underlying objectives of rate regulation as codified in section 3622(b). These objectives include maximizing incentives to reduce costs and increase efficiency, creating predictability and stability in rates, allowing the Postal Service pricing flexibility, and assuring adequate revenues to maintain financial stability. See 39 U.S.C. § 3622(b)(1), (b)(2), (b)(4), (b)(5).

The Commission must also take into account the factors of developing a rate regulation system, including the effect of rate increases on the general public and mail users, the importance of pricing flexibility to encourage increased mail volume and operational efficiency, and the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services. See 39 U.S.C. § 3622(c)(3), (c)(7), (c)(12).

## **B. Summary of Proposals Before the Commission**

Prior to analyzing the primary objectives and factors and their impact on the relevant stakeholders, it is important to first summarize the applicable proposals to be addressed by the Commission. The proposals to be addressed relate to the terminal dues paid by exporting UPU designated operators to importing designated operators for the handling and delivery of international letter post mail. These terminal dues are relevant to the Commission's analysis because they impact the market dominant inbound rates, *i.e.*, the revenue received by the Postal Service for handling, transport

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<sup>2</sup> Rates that the Postal Service pays foreign postal operators for delivery of mail abroad are not subject

and delivery of letter-post items from abroad.

The terminal dues system is a means for UPU member countries to provide remuneration to their designated operators for the reciprocal exchange of international letter post mail. Originally introduced in 1969, the system has undergone numerous refinements to rectify compensating imbalances in mail exchanges. Today, the terminal dues system consists of the target system (primarily for countries with larger volumes and greater levels of postal technology) and the transitional system (for groups of countries with predominantly smaller volumes and lower levels of postal technology that are transitioning to the target system at various speeds). Within the system, countries are classified into groups, from 1.1 to 5, and rates for terminal dues are based on various combinations largely based on the sending and receiving UPU member's group level. At the 2008 UPU Congress, the Postal Operations Council (POC) and the Council of Administration (CA) were given a mandate to develop a proposal for the 2012 UPU Congress to address continuing issues associated with calculating terminal dues and to ensure a smooth and gradual transition for all countries to join the target system.

The CA/POC terminal dues package being submitted to Congress represents the work by both of these UPU Councils over the past four years, taking into account the results of numerous policy surveys and economic studies on domestic rates, costs, mail volumes, mail flow composition, and methodologies to accurately convert domestic tariffs (postage rates) into terminal dues rates. The proposals represent a

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to the section 407(b), because they consist of supplier costs to the Postal Service.

compromise package that was approved by the 40 members of the POC and 41 members of the CA in February/March of this year. The primary UPU Congress proposals addressing terminal dues rates include Proposals 20.27.1, 20.28.1 and 20.29.1. The reasoning for these proposals is based on a joint report of the POC and the CA, UPU Congress Document 20b, UPU Terminal Dues System for the Period 2014-2017. Essentially, the proposals increase terminal dues at a measured and balanced annual rate within a cap and floor system. The proposals also set forth timetables for countries moving from the transitional system to the target system. In essence, the POC Proposals 20.27.1, 20.28.1 and 20.29.1 institute measured increases in the terminal dues rates over the next four years. These proposals are complemented by the joint POC/CA Proposal 37, which is a proposal for a resolution that directs the POC and CA to explore various enhancements to the terminal dues system for the 2016 UPU Congress.

Several primarily Nordic countries have since submitted Proposal 81 after trying to seek support for amendments to the terminal dues proposals to be considered at the upcoming Doha Congress. Proposal 81 consists of a proposal for a resolution amending Proposal 37, the jointly sponsored proposal from the CA and POC regarding future work on the terminal dues system for 2018-2021. As part of the amendments advocated in Proposal 81, the proponents of Proposal 81 seek to amend the instructions from Congress to the effect that the subordinate bodies of the UPU develop proposals for the next Congress to eliminate the cap on terminal dues rates for letter post mail exchanged among target system countries.

As explained below, significant changes to the UPU terminal dues system, particularly those advanced in Proposal 81 or other amendments to remove the cap currently being contemplated, could have significant adverse effects on the mailing community (the general public and other large mail users) and on the Postal Service.

### **C. Impact on the Relevant Stakeholders**

In presenting its view of the terminal dues issues to the Secretary of State pursuant to section 407(c)(1), the Commission should consider the impact on the relevant stakeholders, including mailers who utilize outbound international mail products, the Postal Service, and foreign designated operators and their mail users. The impact on each is discussed below.

#### **1. Impact on Mailers**

Increases in terminal dues rates can have a direct and precipitous impact on mailers, because the Postal Service generally must pass along increases in terminal dues payments to the users of outbound international mail. While mailers can adapt to gradual increases in terminal dues as set forth in the CA/POC proposal, drastic changes, such as those advocated in Proposal 81 or other amendments to remove the cap, would likely result in sudden and substantial increases in costs to outbound international mailers. Depending on the type of mail, terminal dues rates are a significant factor in setting outbound international mail rates, as terminal dues represent an attributable cost to the Postal Service in delivery of outbound international mail. Increasing terminal dues rates, especially significant increases resulting from elimination of the cap or directly tying the rates to domestic mail rates,

would result in a considerable increase in the cost of delivery of letter post mail abroad. To offset this increase, the Postal Service would be forced to cover its costs with rate increases to the mailers. As a result, outbound international mail rates would rise, creating a hardship for both individual and business mailers.

As an illustration,<sup>3</sup> the Postal Service estimates that if the cap in terminal dues were eliminated in the upcoming Convention cycle, rates for outbound international mail would increase as shown below:

- Depending on the destination country, First Class Mail International (FCMI) rate increases would range from 5 percent to well over 60 percent, affecting primarily the general public, *i.e.*, individual mailers who rely on FCMI for international mailings.
- Depending on the destination, International Priority Airmail (IPA) and International Surface Air Lift (ISAL) rate increases would be significantly higher than the 5-60 percent range stated above—nearly 150 percent increase for mail to Denmark, more than 120 percent increase for mail to Norway, and an estimated 70 percent increase for mail to France; large business mailers who use IPA and ISAL services would be severely impacted.

Such drastic increases in terminal dues rates could paralyze the mailing industry and have a devastating effect on mail volume and Postal Service revenue for outbound

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<sup>3</sup> While Proposal 81 proposes that the instructions for lifting of the cap would occur after the 2016 Congress, we offer this illustration to show what the impact is now, because it is difficult to estimate costs and price impacts for the 2018-21 time period.



international mail, because the increase in cost for remuneration would be passed along to mailers. In contrast, efforts to maintain the cap with reasonable increases in terminal dues rates serves to provide stable, affordable, and predictable rates for U.S. mailers in the foreseeable future.

The terminal dues system is used by more than 200 UPU member countries and territories, who make the final decisions at Congress. Eliminating the rate cap was generally rejected by an overwhelming majority of UPU members in numerous terminal dues meetings over the past four years of terminal dues studies, due to the impact on mailers.

In addition, countries have different cost accounting systems and methodologies. It cannot be simply assumed that domestic rates always serve as an appropriate proxy for "costs", especially since a comparison of the domestic rates of "Industrialized Countries" in the target system seems to indicate that some Nordic countries have significantly higher domestic rates than the U.S. postage rate of \$0.45—Norway's domestic postage rate is \$1.55 (245% higher) and Denmark's is \$1.32 (194% higher) as of July 2012. Without more data on what is included in those domestic rates, U.S. rate payers should not be required to subsidize the aspects of foreign operators and governments that may be supported by basic domestic postage tariffs.

The Commission must harmonize the impact of terminal dues on mailers with the requirements of section 3622, which states that the Commission should "create predictability and stability in rates" and highlights "the importance of pricing flexibility

to encourage increased mail volume and operational efficiency.” 39 U.S.C. § 3622(b)(1), (c)(7). Both of these requirements relate to mailers and their ability to economically use mail. The current terminal dues system with reasonable and measured rate increases provides mailers with a reliable and predictable rate system upon which to base their operations, which inherently encourages mailers to increase their volume. In contrast, elimination of the cap would result in significant rate increases and price fluctuation to many destination countries, directly counter to the stated objectives and factors for the Commission to consider under section 3622. Accordingly, the terminal dues system proposed by the CA/POC and the measured provisions of Proposal 37 best accommodate the objectives and factors of section 3622. By contrast, the future system advanced by Proposal 81 could have deleterious effects on the mailing community because of the real and probable risk of rate shock on mailers.

## **2. Impact on the Postal Service**

The overarching premise that must first be understood before addressing the impact of changes in terminal dues on the Postal Service is the status of the U.S. Postal Service as either a net exporter or net importer of letter post mail in exchanges with designated operators in other UPU Member Countries. As a net exporter to certain designated operators, the Postal Service processes significantly greater volumes of outbound international mail than inbound international mail. This implies that in these exchanges, the total terminal dues payments for outbound letter post mail, which represent costs to the Postal Service, far exceed the revenue generated

from terminal dues for inbound letter post mail. Because terminal dues negotiated in the UPU are reciprocal, an increase in terminal dues for inbound letter post mail usually leads to a potentially greater total increase in remuneration to foreign designated operators for U.S. origin mail. Thus, due to the dynamics of reciprocity, generalized efforts to increase terminal dues rates do not serve the financial interests of the U.S. and other net exporters of cross-border mail.

In summary, an increase in terminal dues for letter post mail in the Convention will in most circumstances have an overall adverse financial effect on the Postal Service and its operations. Simply put, proposals that have the effect of increasing terminal dues payments will have an adverse overall financial impact on the Postal Service. As the Commission is aware, the Postal Service is currently operating with significant losses and under a cash shortage. See Form 10-Q for FY 2012, Quarter 3 filed August 9, 2012 and Form 8-K filed August 9, 2012. An increase in terminal dues rates only serves to hasten the financial difficulties for the Postal Service and inhibits its ability to adjust to future changes in international mailing trends.

While the increase in terminal dues rates would result in increased revenue for handling and delivering inbound mail, the extent of the increases if the cap were removed would be excessive for other countries' designated operators to pay (in the range of 50 to 60 percent). Thus, reasonable measures to protect against precipitous increases in terminal dues, such as the retention of caps, generally serve the financial interests of the Postal Service and thereby assure adequate revenues to maintain financial stability as section 3622(b)(5) mandates.

### **3. Impact on Foreign Posts**

While the Commission is not statutorily required to consider the impact on foreign posts when analyzing UPU proposals under section 407, the Commission should be aware of the impact its view may have on the UPU system, particularly other members of the UPU and the inherent foreign policy requirements. Efforts to remove the cap on terminal dues, as suggested in Proposal 81, would have a drastic and devastating effect on many foreign postal operators and their international mailers. In response to new higher terminal dues rates, these posts would be also be required to pass along the rate increases to users of international mail in their countries, further increasing their international mailing rates. In contrast, the CA/POC proposals represent a balanced compromise and more gradual increase in terminal dues rates which necessarily provides greater stability to postal operators and users of the mail worldwide.

#### **D. Review of Draft Comments Submitted in this Docket**

On August 14, 2012, Mr. James Campbell submitted draft comments in this docket. His stated rationale for doing so was to inform those interested in participating in this docket about the subject of terminal dues and the details of the POC proposals. While Order No. 1420 does not provide for reply comments, the Postal Service believes it is appropriate to respond to some of the points raised by Mr. Campbell in his draft comments. Mr. Campbell first provides a summary of the UPU and terminal dues and then proposes his analysis of the POC proposal and why a cap on terminal dues is prejudicial and counter to title 39. He recommends that the

Commission furnish a view to the effect that the cap on terminal dues be eliminated, and that terminal dues rates directly relate to the domestic mail rates for the importing country, similar to the method advocated in Proposal 81. In support of this position, Mr. Campbell suggests that despite the significant savings the Postal Service will receive under the POC proposals, removal of the cap would eventually lead to a more financially independent Postal Service. This policy choice does not, however, remedy the concerns raised above, specifically that eliminating the cap would result in significantly higher rates for outbound and inbound international mail in exchanges with the United States, and increased costs for the users of the Postal Service, the Postal Service, and foreign designated operators and their international mail users. Instead, Mr. Campbell's approach narrowly focuses on the improvement in inbound rates, while ignoring the impact on U.S. senders of international mail, and the Postal Service as a whole.

In addition to the policy bases, the Postal Service also believes it is important to point out some of the factual errors in representations made by Mr. Campbell in his draft comments. Throughout the document, Mr. Campbell refers exclusively to the "POC" proposal, whereas the terminal dues work during this cycle was a combined effort and closely coordinated with the CA that provided its work per the Geneva Congress Resolution. On Page 15 of Mr. Campbell's draft comments, he states (incorrectly) that Brazil and China led the opposition to further transition of Group 3 countries to the target system. This is not accurate, however, as China attempted to lead this opposition, and Brazil does want to join the target system. This unfortunate

misstatement creates confusion and can stir unnecessary dialogue with the countries involved. Also, on page 15, Mr. Campbell states that “[i]n actuality, in almost no country is the terminal dues reflective of domestic postage”. This is also incorrect, as the new methodology being proposed to the Doha Congress does in fact reflect a best-fit linearization of 15 domestic rates collected by the International Bureau. On page 27 of Mr. Campbell’s draft comments, he states that the Postal Service could gain \$4.6 million; however, the model he uses does not reflect real mail volumes between France and the U.S, which bear no relation to the value of trade that Mr. Campbell used in his draft document in this example and, subsequently, in most of the data and calculations in his Appendix B that rely on such an assumption. On pages 30-31, Mr. Campbell reports estimates of potential “gains” to the Postal Service, with a footnote conceding that “[i]t should be noted that the finer the analysis the greater the chances that the assumptions and estimates used to develop the Bilateral Flow Model will give inaccurate results. Therefore, the specific figures in this section in particular should be regarded with caution.”

The State Department, PRC and the Postal Service have been consulting on a regular basis on the CA/.POC proposals based on real mail volumes and impact on U.S. mailers over the past four-year terminal dues cycle. Mr. Campbell’s analysis does little to advance the need for compromise and reasonableness in establishing U.S. government positions in the upcoming Congress.

### **III. Conclusion**

As set forth above, the Commission is tasked solely with providing its view as to whether certain proposals that affect market dominant products are consistent with the standards and criteria of section 3622. The CA/POC proposals advance the objectives of section 3622(b) while satisfying the factors of 3622(c), while Proposal 81 or other amendments to remove cap rates are counter to these requirements. Accordingly, the Postal Service recommends that the Commission present a view to the State Department endorsing the proposals submitted by the CA/POC as they best satisfy the statutory requirements of title 39 and best effectuate the policies, objectives and factors in 39 U.S.C. § 3622.

Respectfully submitted,

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